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Ease over Accuracy in Assessing Patent Settlements

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A response to Herbert Hovenkamp, Mark Janis, and Mark A. Lemley, *Anticompetitive Settlement of Intellectual Property Disputes*, 87 MINN. L. REV. 1719 (2003).

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Settlement payments from patentee-plaintiffs to allegedly infringing defendants in exchange for discontinuance of the allegedly infringing use have drawn much attention recently in government and private antitrust litigation,[1] legal and economic scholarship,[2] and Congress.[3] I have argued that such "re-

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1. *See, e.g.*, Valley Drug Co. v. Geneva Pharm., Inc., 344 F.3d 1294, 1304 (11th Cir. 2003) (rejecting the district court's ruling that payments from the patentee to the alleged infringer in consideration of the alleged infringer's agreement not to market the allegedly infringing product during the pendency of the lawsuit were per se illegal under section 1 of the Sherman Act); *In re* Ciprofloxacin Hydrochloride Antitrust Litig., 261 F. Supp. 2d 188, 250–52 (E.D.N.Y. 2003) (rejecting the claim that "reverse payments" from the patentee to the alleged infringer are per se illegal under section 1 of the Sherman Act); *see also* Daniel A. Crane, *Exit Payments in Settlement of Patent Infringement Lawsuits: Antitrust Rules and Economic Implications*, 54 FLA. L. REV. 747 (2002) (collecting and discussing cases); Scott P. Perlman & Jay S. Brown, *FTC Targets Patent Settlement Agreements: Recent Actions Illustrate Permissible and Unlawful Deals*, NAT'L L.J., Nov. 11, 2002, at C1 (summarizing recent government enforcement actions).

2. *See, e.g.*, Joseph F. Brodley & Maureen A. O'Rourke, *Preliminary Views: Patent Settlement Agreements*, 16 ANTITRUST 53 (2002); Jeremy Bulow, *The Gaming of Pharmaceutical Patents, in* 4 INNOVATION POLICY AND THE ECONOMY (Adam B. Jaffe et al. eds., forthcoming 2004); Thomas F. Cotter, *Refining the "Presumptive Illegality" Approach to Settlements of Patent Disputes Involving Reverse Payments: A Commentary on Hovenkamp, Janis & Lemley*, 87 MINN. L. REV. 1789 (2003); Herbert Hovenkamp et al., *Anticompetitive Settlement of Intellectual Property Disputes*, 87 MINN. L. REV. 1719 (2003); James

verse payments" (also known as "exit payments" or "exclusion payments") should not be accorded per se treatment under the antitrust laws and should be approved so long as the patentee has a strong ex ante likelihood of succeeding on the merits of its infringement claim and thereby excluding the infringing use from the market.[4]

In a recent article in the *Minnesota Law Review*'s Symposium, *The Interface Between Intellectual Property Law and Antitrust Law*, Herbert Hovenkamp, Mark Janis, and Mark Lemley argued that exclusion payments should be presumptively unlawful, subject to an opportunity for the infringement plaintiff to rebut the presumption "by showing both (1) that the ex ante likelihood of prevailing in its infringement lawsuit is significant, and (2) that the size of the payment is no more than the expected value of litigation and collateral costs attending the lawsuit."[5] The authors' proposed test is significantly more restrictive than the test I have proposed: procedurally, it shifts the burden of justifying the exit payment to the settling patentee, and substantively, it caps the permissible amount of the exit payment at the patentee's expected future litigation costs.

Although the authors characterize their proposed test as reflecting antitrust's post-Chicago revolution "preference for accuracy over ease,"[6] I submit that it does the opposite by arbi-

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Langenfeld & Wenqing Li, *Intellectual Property and Agreements to Settle Patent Disputes: The Case of Settlement Agreements with Payments from Branded to Generic Drug Manufacturers*, 70 ANTITRUST L.J. 777 (2003); Jonathan M. Lave, *Responding to Patent Litigation Settlements: Does the FTC Have It Right Yet?*, 64 U. PITT. L. REV. 201 (2002); Carl Shapiro, *Antitrust Limits to Patent Settlements*, 34 RAND J. ECON. 391 (2003); *see also* Crane, *supra* note 1, at 750 n.12 (noting the extensive commentary on antitrust issues in patent dispute settlements).

3. Both houses of Congress have considered versions of the Drug Competition Act of 2003, which requires generic and branded pharmaceutical companies entering into settlements of patent infringement lawsuits to file a notification with the Federal Trade Commission and the Department of Justice within ten days of the settlement. *See* Drug Competition Act of 2003, S. 946, 108th Cong. §§ 1, 5, 6 (2003); Prescription Drug and Medicare Improvement Act of 2003 (Engrossed Amendment as Agreed to by Senate), H.R. 1, 108th Cong. Title IX, §§ 901, 905, 906 (2003) (identifying Title IX as the House version of the Drug Competition Act of 2003); *see also Promoting Availability of Lower Cost Generic Drugs: Hearing Before the Senate Comm. on the Judiciary*, 108th Cong. (2003) (statement of the Honorable Timothy J. Muris, Chairman, Federal Trade Commission), *at* 2003 WL 21784991.

4. *See* Crane, *supra* note 1, at 779–82.

5. Hovenkamp et al., *supra* note 2, at 1759.

6. *Id.* at 1766.

trarily capping the amount of settlement payments due to an erroneous focus on the directional flow of plaintiff-to-defendant settlement payments. As Thomas Cotter argued in his paper in the same Symposium,[7] the authors' test would exclude a range of potentially socially desirable settlements and force patent infringement litigants into protracted, and socially costly, litigation.

I. WHY FIXATE ON THE DIRECTIONAL FLOW OF THE SETTLEMENT PAYMENT?

Hovenkamp, Janis, and Lemley consider payments from patentee-plaintiffs to allegedly infringing defendants "inherently anticompetitive" because the amount the patentee is willing to pay is inversely correlated to the ex ante likelihood that the patentee will prevail on its infringement claim if the case goes to trial.[8] Exactly the same could be said of the plaintiff's incentives in any case involving a settlement providing for the defendant's exit from the relevant market, whether or not cash payment happens to flow from the plaintiff to the defendant. It makes no sense to single out exclusion payments for disfavor when the same potential for collusion arises in any settlement involving the defendant's exit.

For example, if the period of past infringement substantially exceeds the expected future useful life of the patent, a settlement may involve a payment from the defendant to the plaintiff together with an agreement to discontinue the allegedly infringing use, even though the patentee's infringement claim is relatively weak. The defendant's promise to exit the market may not bring enough in present value monopoly profits to cover the patentee's expected damages recovery from the period of past infringement, so the defendant has to make some cash payment in addition to its exit promise to settle the lawsuit.[9] Similarly, the parties may agree to a "walk-away" settle-

7. Cotter, *supra* note 2, at 1802–15.

8. Hovenkamp et al., *supra* note 2, at 1759.

9. *See* Crane, *supra* note 1, at 775. For example, assume the defendant's past period of infringement caused the patentee to lose $1000 in profits, the defendant's exit from the market would bring the patentee $500 in future profits, and the patentee has a fifty percent chance of winning the case. Putting aside any cost savings from settling, the patentee expects to gain $750 from continuing its suit. The patentee will not accept a settlement in which the defendant merely agrees to discontinue the allegedly infringing use in the future. It will require a payment from the defendant of at least $250. The settlement will look "normal" (the defendant pays the plaintiff) even though a

ment where the defendant discontinues the challenged use and the patentee forgoes its claim for damages.[10] No money exchanges hands, but by forgoing the damages claim the patentee has just as certainly bought out the possibility that it will not prevail at trial as if it paid the defendant in cash.

Often, a case will involve both claims and counterclaims for infringement of a series of different patents, or counts in addition to patent infringement. For example, if the plaintiff has a patent infringement claim worth $1000 in future monopoly profits, a breach of contract claim worth $2000 in past damages, and a fifty percent chance of prevailing on each claim, it would be willing to settle the case for a payment from the defendant of $500 plus a stipulated injunction against future "infringement" of the patent. Settlement of such mixed cases not involving the simple model of a patentee suing a defendant on a single patent and paying the defendant to exit the market involves the same "evil" with which Hovenkamp, Janis, and Lemley are concerned: the exchange of consideration for the defendant's exit from the market without an adjudication that the patent claim is good.[11] The authors' test, however, would not make such settlements presumptively illegal and subject to a cap on the settlement payment amount because the patent piece is embedded in a larger, aggregate settlement and the cash payment flows from the defendant to the plaintiff as ordinarily happens in settlements involving only a claim for past damages.[12]

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portion of the consideration is the monopoly profits the patentee will reap once the defendant exits, just as in the sort of cases with which the authors are concerned.

10. For example, if the patentee has a damages claim with a present expected value of $1000 and its expected value from the defendant's exit from the market is also $1000, the patentee would be willing to forgo its damages claim in exchange for the defendant's exit from the market.

11. Hovenkamp et al., *supra* note 2, at 1759.

12. The authors recognize that patent infringement settlements involving a defendant's cessation of the challenged use without a "substantial exclusion payment" may still raise concerns, but would allow such a settlement if a "not . . . particularly searching" inquiry concluded the settlement was not a "sham." *Id.* at 1760. If by "sham" the authors mean a settlement in which the parties are aware that the patentee will not prevail at trial but purposefully use the lawsuit as a cover for a market division agreement, then the category of settlements not involving "exclusion payments" that the authors would find problematic is very narrow. For example, a case in which the patentee thinks it has a forty percent chance of winning at trial probably does not count as a "sham," but the social costs of allowing the defendant to exit the market in consideration of settling with the plaintiff (whatever the currency of settle-

Where a settlement agreement involves a party's promise to exit a market absent any adjudication that the party is legally required to exit, the currency of the settlement (cash payment, forgoing a past claim for damages, forgoing a different legal claim, or some other agreement) is generally unimportant. The social cost of settlements involving the defendant's exit from the market derives solely from the fact that the defendant might not have had to exit if it had won the patent suit. If, ex ante, there is a ten percent chance that the defendant will prevail in the patent suit and the deadweight losses caused by the absence of competition in the market would be $1000, the cost of the defendant's exit is $100 (putting aside the offsetting social benefits of settlements). The flow of the financial payments in the settlement does not cause that social cost to increase or decrease. At most, the structure of the settlement may provide some evidence of the parties' own valuation of the strength of the lawsuit, although relying on directional flow to determine ex ante predictions about the probable outcome of the lawsuit would be difficult or impossible in many cases.[13] Standing alone, the directional flow of the settlement payment is a poor proxy for determining the ex ante likelihood that the plaintiff would prevail at trial and legally exclude the defendant.

Settlements involving a cessation of some competitive activity by the defendant are not unique to patent litigation. Similar issues could arise in litigation over covenants not to compete, territorially limited franchises, trademarks, tortious interference with contracts, or various kinds of unfair competition or misrepresentation claims. In many such cases, the litigants may have incentives to divide markets and split monopoly rents under the guise of settling a legal dispute, and these incentives should be of concern to the courts and law enforcement agencies. But use of the direction in which settlement payment flows to determine which settlements raise concern will lead to an unduly high number of false positives and false negatives.

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ment) exceed the social gains of allowing the settlement.

13. *See* Crane, *supra* note 1, at 790.

II. WHY CAP THE SETTLEMENT PAYMENT AT THE PATENTEE'S EXPECTED OUT-OF-POCKET LITIGATION COSTS?

Hovenkamp, Janis, and Lemley would make per se illegal any settlement payment from a patentee to an alleged infringer that exceeded the "expected value of litigation and collateral costs attending the lawsuit."[14] Their proposed rule is based on the view that any settlement payment from a patentee to a defendant consists of two elements of value to the patentee: (1) "the cost of continued litigation" and (2) "the value of eliminating competition that the patentee could not expect ex ante to exclude after trial."[15] Since the elimination of competition element is illegitimate from an antitrust perspective, the authors subtract it from the equation, thereby deriving the "cost of continued litigation" cap on the amount of any "exclusion payment."[16]

The soundness of the authors' analysis of the economic value of "exclusion payments" to patentees depends largely on the definition of "cost of continued litigation."[17] Taking the broadest definition, their observation might be substantially true. But the authors take a narrow view of cost and would limit their proposed cap to "out-of-pocket costs and attorney's fees,"[18] essentially the costs that are recoverable under ordinary fee-shifting regimes.

This standard falls far short of accounting for the many costs of litigation that firm managers consider in deciding whether to settle. Fee-shifting statutes, which the authors' proposed rule essentially tracks in categorizing relevant costs, do not permit recovery of all of the costs firms incur when they litigate.[19] Patent managers understand that their costs of litigating far exceed their direct out-of-pocket expenses.[20] Firm employees often spend as much time as their lawyers preparing the case, producing documents, working with lawyers on litigation strategy, being deposed, traveling for lawsuit-related

14. Hovenkamp et al., *supra* note 2, at 1759.

15. *Id.* at 1758.

16. *Id.*

17. *Id.*

18. *Id.* at 1760 n.177.

19. *E.g.*, Janet Cooper Alexander, *The Value of Bad News in Securities Class Actions*, 41 UCLA L. REV. 1421, 1439 (1994).

20. ANTHONY L. MIELE, PATENT STRATEGY: THE MANAGER'S GUIDE TO PROFITING FROM PATENT PORTFOLIOS 17–18 (2000).

events, testifying at trial, and observing legal proceedings. Litigation may require deposing or seeking documents from suppliers or customers or engaging in other public conduct that may embarrass the litigants or damage relationships with third parties.[21] Broad discovery rules require the production of documents and sensitive competitive information for which protective orders fail to provide adequate assurance of confidentiality.[22] The length of patent litigation may itself impose costs on the patentee by making marketing, research and development, and other business planning difficult while the outcome of the case remains uncertain.[23]

These and other indirect costs of continuing to litigate may explain patentees' eagerness to settle infringement lawsuits for payments to the defendants in excess of their expected out-of-pocket litigation costs, even when the patentees have a strong ex ante likelihood of ultimately succeeding in the lawsuit. Unlike direct litigation costs, these expected indirect costs are probably too difficult to quantify to form the basis of the sort of rule that Hovenkamp, Janis, and Lemley propose. That is not a ground for excluding them from the calculus, but for not imposing a cost-based cap on the settlement amount at all.

In addition to these indirect costs of litigation, patentees may choose to settle because of risk aversion,[24] which itself could be called a "cost" of continued litigation. Similarly, if the firm's shares are publicly traded, the firm may have invested considerable sums in research and development to obtain the patent with assurances to shareholders of a profitable return on the investment. An unexpected loss of the patent lawsuit may cause management to lose credibility with shareholders and lead to a greater decline in the value of the company's shares than the lost net present value of future monopoly profits from winning the patent case.[25] Settling allows management

21. *E.g.*, Tate Access Floors, Inc. v. Interface Architectural Res., Inc., 185 F. Supp. 2d 588, 604 (D. Md. 2002) (noting that the defendant used the testimony of customers in attempting to show the invalidity of the patent due to obviousness).

22. *See* Crane, *supra* note 1, at 758–59 (explaining that patent litigation often requires sharing of sensitive competitive information in discovery and that protective orders limiting access to such documents to attorneys involved in the case are "difficult to enforce").

23. *See infra* notes 28–30 and accompanying text (illustrating this problem).

24. Cotter, *supra* note 2, at 1806–07.

25. *See, e.g.*, Lawrence Ingrassia, *Polaroid Falls 22% on Negative News*,

to eliminate the possibility of unexpected bad news that might have wider ripple effects for the firm.

In sum, patentees look to settle patent infringement lawsuits for a variety of reasons, including out-of-pocket litigation costs, unrelated to "the value of eliminating competition that the patentee could not expect ex ante to exclude after trial."[26] The authors' rule would disregard these costs and impose an unduly restrictive cap on patent infringement settlements.

III. THE SOCIAL COSTS OF LIMITING PATENT SETTLEMENTS AND THE LIMITED RELEVANCE OF A LICENSING ALTERNATIVE

Hovenkamp, Janis, and Lemley approach patent settlements involving exit or nonentry by the defendant from the perspective of avoiding deadweight social losses that occur when monopolists reduce output in order to increase price. If ex ante there is a twenty percent chance that the patentee will lose an infringement case in which victory would bring a deadweight loss of $1000 to society, the social cost of permitting a settlement in which the defendant exits the market is $200—*from the antitrust perspective*. But there is another side to the story to which the authors devote few comments: the effects on the incentive-reward system of the patent laws of curtailing patentees' control over the process of legally vindicating their patent rights. By severely limiting patent settlements, the authors' rule would undermine a major goal of patent law, that of encouraging investment in innovation.[27]

The potential social costs of the authors' rule are many. Most obviously, if the rule results in prolonged litigation it will impose on the patentee the costs identified in the previous section, which reduce the value of the patent and therefore the in-

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WALL ST. J., Oct. 16, 1990, at C1 (reporting that Polaroid's stock price fell twenty-two percent in reaction to a lower-than-expected damage award in its patent infringement lawsuit against Kodak). Empirical research shows that shareholders punish management more for unexpected bad news than they reward management for unexpected good news. Werner F.M. De Bondt & Richard H. Thaler, *Further Evidence on Investor Overreaction and Stock Market Seasonality*, 42 J. FIN. 557, 557–58, 577–79 (1987); Werner F.M. De Bondt & Richard H. Thaler, *Does the Stock Market Overreact?*, 40 J. FIN. 793, 799 (1985).

26. Hovenkamp et al., *supra* note 2, at 1758.

27. *See infra* notes 28–30 and accompanying text (discussing this disincentive).

centive to engage in inventive activity.[28] Or the patentee may be able to pass along the costs to its customers, who will then bear the brunt of the settlement restriction. Prolonged litigation may also freeze inventive activity for years because of the uncertainty over whether the alleged infringer will be allowed to participate in the market with its current technology or will be required to invent around the patent and to find an alternative, noninfringing way of entering. Because the expected damages award consists of the patentee's monopoly profits, infringement defendants have an incentive to stay off the market during the period of the lawsuit because their expected losses from making sales exceed their expected gains (unless the patentee's case is very weak).[29] The defendant can only gain market share at a competitive price if it sells the allegedly infringing product during the course of the litigation. An early settlement eliminates the uncertainty over the scope and validity of the patent and may lead the defendant to invent around the patent earlier than if it had awaited the outcome of the patent lawsuit.[30]

The authors' rule would also have undesirable effects on new firms' incentives to attempt entry. As Jerry Hausman has shown, a rule restricting patent settlements will have the effect of increasing the anticipated costs of litigation for any firm considering entering a patent-intensive market.[31] Patent settlements thus have the procompetitive effect of reducing barriers to entry.[32] Conversely, restricting patent settlements increases barriers to entry by increasing litigation costs that are often necessary for entry.[33]

28. Cotter, *supra* note 2, at 1809–10.

29. *See, e.g.*, Bayer AG v. Elan Pharm. Research Corp., 212 F.3d 1241, 1247 n.5 (Fed. Cir. 2000) (noting that a generic pharmaceutical manufacturer chose to delay marketing its drug until resolution of a branded firm's infringement lawsuit).

30. Crane, *supra* note 1, at 764.

31. *In re* Ciprofloxacin Hydrochloride Antitrust Litig., 261 F. Supp. 2d 188, 256–57 (E.D.N.Y. 2003) (quoting the expert declaration of Jerry Hausman for the proposition that "'[t]he ability to settle a patent challenge on flexible terms can have a pro-competitive effect because it increases the number of patent challenges by decreasing barriers to entry.'").

32. *Id.*

33. Hovenkamp, Janis, and Lemley call this argument "perverse" because "in the pharmaceutical industry the settlement in question, an exclusion payment, prevents entry altogether, not just by the settling firm, but by any other generic as well" due to a loophole in the Hatch-Waxman Act. Herbert Hovenkamp, et al., *Balancing Ease and Accuracy in Assessing Pharmaceutical Exclu-*

Hovenkamp, Janis, and Lemley do not believe that their proposed rule would "necessarily impede settlement[s]," because the parties can always agree to settle through a license arrangement which enables "more competition while allowing the parties to avoid the costs of uncertainty."[34] Two brief responses are warranted.

First, a licensing agreement does not necessarily ensure competition, and virtually ensures that the defendant's price to customers will exceed the price it would have charged if it had simply marketed the product without having to pay a royalty to the patentee. A license may also give the patentee control over the alleged infringer's price, quantity, or sales territory.[35] As Hovenkamp explains in his antitrust treatise, "firms cartelizing a market may agree to use a licensing agreement to give effect to a territorial division scheme, with the agreement covering a patent of dubious validity."[36] A settlement involving a licensing agreement prior to any adjudication that the patent rights licensed are in fact enforceable poses many of the same risks of monopolistic behavior by the licensor and licensee as "exclusion payments." The defendant, who previously asserted that it had the right to compete without permission of the patentee, now agrees that it must pay the patentee for the right to compete and to accept those conditions on its competitive behavior that the patentee chooses to impose.[37] Indeed, some settlements in

sion Payments, 88 MINN. L. REV. 712, 716–17 (2004). As I have noted elsewhere, the concerns created by the 180-day generic exclusivity rule to which the authors are referring can be resolved by requiring the settling generic to waive its statutory claim to exclusivity if it settles a patent infringement lawsuit. *See* Crane, *supra* note 1, at 795–96.

34. Hovenkamp et al., *supra* note 2, at 1760–61.

35. HERBERT HOVENKAMP, FEDERAL ANTITRUST POLICY: THE LAW OF COMPETITION AND ITS PRACTICE § 5.5c1 (2d ed. 1999).

36. *Id.* § 5.5c2.

37. The authors' assertion that "licensing is generally a procompetitive practice," Hovenkamp et al., *supra* note 33, at 717, may be overbroad as applied to licensing agreements in the settlement of patent lawsuits. Courts and the antitrust enforcement agencies generally favor licensing of intellectual property because they assume that the licensee would have been unable to use the intellectual property absent the license. When the licensee and licensor would have been competitors absent the licensing arrangement, antitrust concerns arise. *See* U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, ANTITRUST GUIDELINES FOR THE LICENSING OF INTELLECTUAL PROPERTY § 3.1, 7 (1995) (stating that "antitrust concerns may arise when a licensing arrangement harms competition among entities that would have been actual or likely potential competitors in a relevant market in the absence of the license (entities in a 'horizontal relationship')"). In a patent infringement lawsuit between branded and generic pharmaceuticals, the generic is claiming that it is entitled to be

which the defendant accepts a payment from the plaintiff to discontinue the allegedly infringing use may be preferable to licensing settlements because the defendant may thereafter invent around the patent and enter the market in unfettered competition with the patentee, but without infringing the patent.[38]

Second, firms may be reluctant to license their patents because the licensee may free ride on the patentee's promotional efforts or dilute the value of the patent through poor production or marketing of the patented product.[39] Hovenkamp, Janis, and Lemley acknowledge this limitation on the licensing option (although they believe it to be rare), but dismiss it as an argument for permitting exclusion payments because the patentee is free to not settle at all.[40] That observation, however, only questions whether we are better off with a blanket rule against exclusion payments that exceed expected out-of-pocket litigation costs or with a rule that acknowledges that these settlements may be socially optimal when the patentee has a strong chance of succeeding in its patent infringement claim. If settlements involving a defendant's cessation of the allegedly infringing use in exchange for a payment from the patentee exceeding the patentee's expected out-of-pocket litigation expenses are sometimes socially preferable to continued litigation, the hypothetical possibility of an alternative licensing solution does not support adoption of the authors' per se rule.

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the branded firm's competitor without a license. When the generic drops that assertion and accepts a license prior to adjudication of its defense, the same concerns arise as when the generic agrees to exit the market as part of a settlement.

It is not difficult to imagine how a patentee with a weak infringement claim could assure the continuity of its monopoly profits by settling through a licensing arrangement. For example, the patentee could assign the licensee an exclusive sales territory and collect a royalty even while it continued to collect monopoly rents in its own sales territory. In the licensing context, just as in the "exclusion payments" context, the ex ante strength of the infringement claim, not the form of the settlement, should drive the antitrust assessment.

38. *See* Crane, *supra* note 1, at 768–69. The settling patentee may try to prevent the defendant from inventing around the patent by broadening the scope of the settlement agreement to include activities not covered by the patent's claims. *Id.* at 769. However, Hovenkamp, Janis, Lemley, and I agree that any such overbroad settlement would be illegal. *Compare* Hovenkamp et al., *supra* note 2, at 1764–65, *with* Crane, *supra* note 1, at 792–96.

39. Crane, *supra* note 1, at 767–68.

40. Hovenkamp et al., *supra* note 2, at 1761 n.180.

IV. WHOSE BURDEN IS IT?

While my principal objection to Hovenkamp, Janis, and Lemley's proposed rule relates to their proposed cap on "exclusion settlement" payments, I also differ with their view that all payments from a patentee to an alleged infringer should be presumptively illegal, subject to the defendant's right to rebut the presumption of illegality under defined circumstances.[41] While it may be sensible to require the settling parties to document the strength of the patentee's infringement claim, placing the burden of persuasion on the settling parties would unduly chill patent infringement settlements.

On a practical level, the allocation of the burden of *production* may be relatively unimportant. The determining factor in whether to approve or to disapprove patent settlements involving the defendant's exit or nonentry should be the ex ante likelihood that the defendant would be excluded from the market if the case was finally adjudicated. The settling parties typically will have the most information on that topic and will, therefore, be in the best position to produce information justifying the settlement.[42] Wherever the burden is technically placed, the settling parties' own information usually will become the fulcrum of the antitrust analysis, and there is relatively little social cost in requiring the settling parties to retain documents going to the core issues in the patent infringement lawsuit. Placing the burden of *persuasion* on the settling parties, however, would chill patent infringement settlements by making them presumptively illegal under section 1 of the Sherman Act.[43] One does not envy the patentee's general counsel who has to inform senior management that by settling a patent infringement lawsuit they will presumptively become criminals and subject to fines and imprisonment unless they can persuade a jury that they likely would have won the patent infringement lawsuit anyway. Such a rule would also encourage unfounded treble damages lawsuits against the settling parties, since consumers could sue simply by alleging that a settlement involving an exclusion payment occurred, regardless of the strength of the patentee's infringement suit. From the perspective of the outside

41. *Id.* at 1759.

42. *See generally* Bruce L. Hay & Kathryn E. Spier, *Burdens of Proof in Civil Litigation: An Economic Perspective*, 26 J. LEGAL STUD. 413, 419 (1997) ("Other things being equal, the lower one party's relative costs, the stronger the argument for giving him the burden of proof.").

43. *See* 15 U.S.C. § 1 (2000).

observer, Hovenkamp, Janis, and Lemley's proposed rule sends the message that patent settlements involving exit payments are inherently suspect, even though many such settlements are socially desirable.

Pending legislation may partially rationalize the burden question in the pharmaceutical industry, the locus of the recent controversy over patent settlements. The Drug Competition Act[44] will require the settling parties to notify the antitrust enforcement agencies of most patent infringement settlements within ten days, giving the agencies an opportunity to investigate and to shape the settlements through injunctive litigation (or the threat of litigation). As a practical matter, government involvement in pharmaceutical patent settlements may come to resemble Hart-Scott-Rodino merger review,[45] where the burden of proving the merger anticompetitive lies with the government but practically shifts to the merging parties seeking to avoid the cost, embarrassment, and delay of a government lawsuit.[46] Requiring the settling parties to justify their settlement in discussions with the government at the time of the settlement is reasonable, but presumptively exposing them to criminal liability and treble damages suits is not.

CONCLUSION

Crafting a simple legal rule makes sense when its application is likely to reach the optimal result most of the time and the costs of applying a more complicated rule would exceed its benefits.[47] The per se rule proposed by Hovenkamp, Janis, and Lemley meets the test of simplicity, but not the test of general accuracy. By focusing the attention of courts and antitrust regulators on the direction in which settlement payments flow, the per se rule diverts attention from the fact that the strength of the patent infringement suit, not the monetary structure of the settlement, determines whether the settlement is socially

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44. *See supra* note 3 (discussing the Drug Competition Act of 2003).

45. *See* 15 U.S.C. § 15c (2000).

46. The Drug Competition Act does not give the government one of its most powerful tools under the Hart-Scott-Rodino Act: the ability to hold up the merger pending satisfaction of a Second Request. *See* Ashutosh Bhagwat, *Modes of Regulatory Enforcement and the Problem of Administrative Discretion*, 50 HASTINGS L.J. 1275, 1292–93 (1999) (discussing the Hart-Scott-Rodino Act's influence over the application of antitrust law to corporate mergers).

47. *See generally* Richard A. Epstein, SIMPLE RULES FOR A COMPLEX WORLD (1995) (proposing a return to simple rules in different substantive areas of law).

beneficial or costly. By capping patent settlements involving a plaintiff-to-defendant payment at the plaintiff's expected out-of-pocket legal expenses, the rule would make per se illegal many socially beneficial settlements. If a court or antitrust enforcement agency concludes that the patentee's claim is likely to succeed, then placing restrictions on the direction in which payment can flow in the settlement or capping the amount of the settlement at the patentee's expected out-of-pocket litigation expenses is unwarranted.